FAIR POLITICAL PRACTICES COMMISSION
Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

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Subject: Prenotice Discussion of Amendments to the Aggregation Regulations— Regulations 18225.4 and 18428, and Adoption of Regulations 18215.1, 18205 and 18513.11.

Date: January 10, 2006

I. EXECUTIVE SUMMARY

This regulatory project examines Commission rules for combining two or more payments for contributions or independent expenditures that are made from different sources, and the procedures for reporting those payments. The rules defining how this process is accomplished are referred to as the "aggregation provisions."

Currently, contributions or independent expenditures are aggregated, and treated as if made from one source, when the payment made from each source is directed and controlled by the same individual or a majority of the same persons. (Sections 84211 and 85311.) This rule, which dates back to two 1976 Commission opinions ─ *In re Lumsdon* (1976) 2 FPPC Ops. 140 and *In re Kahn* (1976) 2 FPPC Ops. 151, has been in effect for most of the history of the Political Reform Act, (the "Act"). [1] Determining when aggregation applies, for both reporting and contribution limits, can be a very specific factual inquiry. Therefore, regulatory action in this area has sometimes depended on whether or not contribution limits are in effect. The current language of section 85311 originated in a Commission regulation (18215.1), which was originally adopted in 1995 from language taken from the first regulation implementing contributions limits under Proposition 73. Section 85311 was adopted as part of Proposition in 34, which passed in 2000.

Staff believes that it is appropriate at this time for the Commission to more specifically define the aggregation requirements under the Act for both reporting and contribution limits and for state and local candidates. Additionally, although the concept of aggregation is included in section 85311, the Commission, at present, does not have a regulation defining when contributions are aggregated. This regulation is needed because

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[1] Government Code sections 81000 – 91014. Commission regulations appear at Title 2, sections 18109-18997, of the California Code of Regulations. All statutory references are to the Government Code unless otherwise indicated.

section 85311 is limited to state candidates. However, the Commission's longstanding policy regarding aggregation applies to all reportable contributions. Therefore, a regulation is needed to fill the gap and apply the aggregation rule in all contexts.

This regulatory project includes five new or amended regulations:

First, staff proposes a new regulation 18215.1. The proposed new regulation 18215.1 contains the identical language used in section 85311, but adds language defining the term "aggregate" and "whose contributions are directed and controlled" (as defined in proposed new regulation 18205). It fills the void mentioned above and clarifies that the aggregation rules apply in all contexts under the Act.

Second, staff proposes amendments to regulation 18225.4. Regulation 18225.4 was added when regulation 18215.1 first was adopted by the Commission in 1995, and it applies the same aggregation rules for independent expenditures. These amendments would make regulation 18225.4 consistent with the other new proposed regulations.

Third, staff proposes amendments to regulation 18428. Regulation 18428 is a long-standing regulation defining the reporting requirements for aggregated contributions and independent expenditures. Although regulation 18428 was previously amended after section 85311 went into effect, staff recommends that the Commission consider further amendments to clarify, among other things, when an entity's contributions or independent expenditures are aggregated and how those aggregated payments are reported.

Fourth, staff proposes new regulation 18205. This proposed regulation further defines the "direction and control" standard and sets forth standards to determine when entities are acting independently of their majority owner. At the interested person's meeting held on this topic on May 19, 2005, commenters suggested more guidance is needed in this area and stated that it would be helpful to have clear easy-to-follow rules. Staff believes that this is additionally necessary with the enactment of Proposition 34's contribution limits, and seeks further Commission guidance as to what factors need be considered in determining direction and control, and what conditions constitute "acting independently" in order to rebut the presumption of direction and control by majority–owned entities.

Fifth, staff proposes new regulation 18531.11. This proposed regulation 18531.11 references the requirements of section 85311 to the proposed provisions of new regulation 18205 defining direction and control and what factors are to be examined in considering whether an entity acts independently from its majority owner.

II. OVERVIEW

The Political Reform Act establishes certain monetary thresholds for reporting purposes. For example, section 82013 defines a "committee" as any person or combination of persons who: (a) receives contributions of $1,000 or more in a calendar year – a recipient committee; (b) makes independent expenditures of $1,000 or more in a

calendar year – an independent expenditure committee; or (c) makes contributions totaling $10,000 or more in a calendar year – major donor committee. Once a person or combination of persons meets any of these requirements, the committee is required to file certain periodic campaign reports reflecting its activity.

Under long-established policy, codified in the regulations discussed below, the Commission has provided that in certain circumstances, contributions or independent expenditures made from different sources must be combined and treated as if from the same source in meeting these thresholds. For example, if an individual makes a contribution from his or her personal funds and then makes an additional contribution from a business entity in which he or she is the sole owner, in most circumstances the contributions must be combined into one total when meeting the major donor threshold under section 82013, subdivision (c). The two contributions are "aggregated" into one total contribution.[2]

In the past, these aggregation provisions have applied primarily to the major donor reporting requirements. However, with the passage of Proposition 34 in November 2000, which established campaign contribution limits for candidates for state elective office, the Commission's long-standing policy on aggregation of contributions was incorporated into the Act in section 85311. As a result, staff recommends that the Commission reexamine the current rules to determine if they provide sufficient clarity and an appropriate methodology for fully implementing the Act's provisions imposing campaign contribution limits, while simultaneously providing sufficient mechanisms for the enforcement of those provisions to further the purposes of the Act. *Specifically, do the rules adopted in 1976 to fit major donor committee reporting requirements provide sufficient guidance as applied to the campaign contribution limits existing today?*

The following section provides a summary of Commission actions regarding its policy on aggregation, including the opinions in *Lumdson* and *Kahn*, the regulatory implementation of those opinions and changes in the regulations resulting from amendments to the Act as a result of various propositions addressing contribution limits, and including the interpretation of the Commission's aggregation provisions through advice letters. A discussion of the regulatory issues addressed in this project begins at page 14.

III. HISTORY – COMMISSION OPINIONS

In tracing the history of the Commission's rules regarding aggregation, all roads lead back to two 1976 Commission opinions – *In re Lumsdon* (1976) 2 FPPC Ops. 140 and *In re Kahn* (1976) 2 FPPC Ops. 151. A thorough examination of these opinions is therefore necessary in understanding the evolution of the aggregation rules, and in considering what additional provisions might both improve clarity and certainty in

[2] Throughout the long history of Commission opinions and advice letters on this subject, these types of contributions have been variously referred to as "cumulated," "combined," "aggregated," and even "totaled." Staff believes that the term "aggregated" is the most appropriate term and leads to the least amount of confusion, distinguishing these types of contributions from the cumulative totals of contributions required to be reported from one campaign report to the next.

determining when contributions and independent expenditures must be aggregated under the provisions of the Act. Both opinions addressed the circumstances in which two or more persons[3] would be considered a committee, having each of their contributions combined into one single total amount for purposes of meeting the then $5,000[4] contribution threshold to qualify as a major donor committee under section 82013, subdivision (c).

A. ***Lumsdon* Opinion.**

In the *Lumsdon* opinion, the Commission established basic guidelines to be considered under three different factual situations involving an individual's relationship to a corporate entity, and whether that relationship consisted of sufficient evidence to establish them as a "combination of persons" for meeting the definition of committee and aggregating their contributions for purposes of the major donor reporting requirements.

1. First factual scenario: where an individual has a majority ownership in a closely held corporation, the individual's and the corporate contributions are aggregated.

In *Lumsdon*, *supra*, the Commission was presented with the primary question of whether or not an individual must "cumulate" his or her contributions with those of a closely held corporation, in which the individual was the majority shareholder, for the purpose of determining whether the individual and the corporation were a major donor committee pursuant to section 82013, subdivision (c).

The Commission established a presumption that when an individual has a majority ownership in a closely held corporation, the necessary alliance exists between the individual and the entity to establish them as a committee and to combine their contributions in determining major donor status. Therefore, personal contributions of individuals were required to be cumulated when they are majority shareholders of a closely held corporation.

The Commission stated that this presumption is "inapplicable only if it is clear from the surrounding circumstances that [both the individual and the entity acted] completely independently of the other."

However, whether or not there was an implicit agreement to accomplish a common political goal was deemed important, as well as whether or not an individual acted independently from the actions of the corporation or corporations. In *Lumsdon, supra,* the Commission further explained:

> "By definition, a majority shareholder exercises almost complete control over the activities of a closely held corporation. He, for all

[3] Section 82047 defines "person" as "an individual, proprietorship, firm, partnership, joint venture syndicate, business trust, company, corporation, *limited liability company*, association, committee, and any other organization or group of persons acting in concert." (Emphasis added.) Excepting the italicized language, the definition was the same in 1976 when the Commission considered *Lumsdon* and *Kahn, supra*.

[4] The current level is $10,000.

> practical purposes, appoints the board of directors and the officers of the company and they are subject to his ultimate direction in arriving at decisions. If they are not responsive to his desires, he can easily replace them. Accordingly, corporate action generally reflects the judgment and beliefs of the majority shareholder. Moreover, to ignore the nature of the relationship between a majority shareholder and his closely held corporation and treat them as separate entities would have the effect of raising the major donor reporting threshold from $5,000 to $10,000 for all such majority shareholders.
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> "We will assume, therefore, that when [the individual] and [his closely held corporation] make contributions they do so pursuant to at least an implicit agreement to accomplish a common political goal and are a 'combination of persons' within the meaning of Section 82013. This assumption will be inapplicable only if *it is clear from the surrounding circumstances* that [the individual] and [his closely held corporation] *acted completely independently of each other.*" (Emphasis added.)

2. Second factual scenario: where an individual is the president of a corporation, the contributions of the individual and the corporation are combined if there is an agreement or mutual understanding.

Secondary questions in *Lumsdon* were whether or not contributions must be combined between the same individual and another corporation, where the individual was the president of the corporation, or between the individual and the same corporation, by virtue of the fact that the individual served as one of three trustees of a charitable foundation which owned all of the stock of that corporation, where the three trustees voted the shares of the corporation and elected its board of directors. The Commission's analysis was based on whether the individual and the various entities were a "combination of persons" under the statutory definition of committee.

With respect to the first of the two remaining questions regarding the individual's position as the president of a corporation, the Commission found that the president, unlike a majority shareholder of a closely held corporation, "usually exercises a more limited degree of control over corporate decision-making." Since a president "acts subject to the supervision of the board of directors" and "generally is not free to contribute corporate funds according to his own political preferences and thus cannot automatically accomplish a unified goal by combining personal and corporate funds," the contributions of the president and the corporation would be combined for major donor committee filing status "only if there is an agreement or mutual understanding that the corporate and personal funds should be contributed toward the accomplishment of a common political goal."

The Commission, however, added a caveat:

> "We hasten to add, however, that the requisite agreement can be implied as well as express and that a formal manifestation of the agreement is not necessary. Moreover, if in fact [the individual] *is the dominant influence in determining what contributions should be made by [the corporation], the possibility that such an understanding exists is significantly enhanced.*" (Emphasis added.)

3. Third factual scenario: When an individual has power to act on behalf of a corporation, the same principles apply as to the corporate president; however, there is greater flexibility.

The Commission applied the same reasoning regarding the question of combining contributions from the individual and the corporation as a result of the individual's position as one of three trustees controlling the corporation, finding that "[o]nly if there is evidence of an agreement or mutual understanding, express or implied, that the contributions are to be made for a unified purpose will the requisite combination be present." The Commission indicated that this reasoning was based on the fact that since "only a majority of the … trustees can vote the … stock, [the individual's] ability to impose his political judgments on the corporation is limited. He necessarily must obtain the concurrence of at least one other trustee before corporate action will be authorized."

However, the Commission again indicated that there was some flexibility in making this determination, that the rule was not a fixed one, and may result in a different finding depending on the factors involved in any particular case.

> "Of course, this does not mean that in reality [the individual's] power with respect to campaign contributions is only one vote of three. Perhaps by virtue of his position as president of [the corporation] and as a trustee, the other trustees defer to his judgment or accord him a great deal of discretion with respect to a wide range of corporate issues and thus, in actuality, he exercises more power than an individual who owns one-third of the shares of a corporation. If this is the case, the possibility of an implied agreement between [the individual] and [the corporation] undoubtedly is enhanced.
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> "*It is, however, impossible on the basis of the limited facts before us to reach a definitive conclusion*. For purposes of this opinion we, therefore, limit ourselves to enunciation of a standard and leave it to the persons involved to apply that standard." *Lumsdon, supra*.(Emphasis added.)

In summary, under the first set of facts, the Commission established a presumption that when an individual has a majority ownership in a closely held corporation, the necessary alliance exists between the individual and the entity to establish them as a committee and to combine their contributions in determining major

donor status. This presumption is "inapplicable only if it is clear from the surrounding circumstances that [both the individual and the entity acted] completely independently of the other."

Under the facts presented in each of the other situations addressed, the Commission found that between a corporate president and the corporation, and between a member of a three-member board of trustees and the corporation it controls, no such "necessary alliance" existed to presume that they were a "combination of persons," and their contributions would not be combined for major donor purposes "unless there is an agreement or mutual understanding, express or implied, that the corporate and personal funds will be contributed toward the accomplishment of a common goal."

B. ***Kahn* Opinion: Parent corporations and subsidiaries.**

Less than two months after the Commission issued its opinion in *Lumsdon*, it was asked to address a similar question. In *Kahn, supra*, the facts concerned a California corporation listed on the New York Stock Exchange that was the sole shareholder of approximately 15 wholly owned subsidiaries operating in California and another 10 subsidiaries operating outside the state. With a few exceptions, every director of a subsidiary was also a director of the parent corporation. However, the directors did not exercise any control over the operations of the subsidiaries and were never involved in decisions to make campaign contributions. Instead, it was the officers of each subsidiary, most of whom were not directors, who made the decisions to make campaign contributions.

The facts submitted further indicated that the decisions to make campaign contributions were made independently of the parent corporation and without "coordination or direction" by the parent corporation. The parent did establish a maximum limit for any expenditure to be made (including contributions) without its approval, but within that limit the subsidiary could contribute "what it wishes, when it wishes and to whom it wishes." Additionally, the subsidiaries did not "coordinate" their political activity with each other.

Based on these facts, the question presented was whether contributions of the parent and its subsidiaries should be aggregated to determine whether the parent and its subsidiaries were a committee as defined in section 82013, subdivision (c). Applying the analysis from its *Lumsdon* opinion, the Commission stated:

> "In *Lumsdon*, we assumed that the relationship between a majority shareholder and his closely held corporation is an alliance constituting a 'combination of persons' because of the control that the majority shareholder exercises over the activities of the closely held corporation. The relationship between a parent corporation and its wholly owned subsidiaries is similar to the relationship between a majority shareholder and his closely held corporation. Even if the subsidiary corporations are independently managed, the officers of the subsidiaries ultimately are responsible to the parent corporation.

> Furthermore, if the decisions of the officers of the subsidiaries are not responsive to the overall desires of the parent corporation, the officers can be removed by the directors. Because of these similarities, we believe that it is appropriate to apply the standard developed in *Lumsdon* to a parent corporation and its wholly owned subsidiaries.
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> "We will assume, therefore, that *when a corporation and its wholly owned subsidiaries make contributions they do so pursuant to a least an implicit agreement to accomplish a common political goal and are a 'combination of persons' within the meaning of Section 82013.* Consequently, the parent corporation and its subsidiaries will be a 'committee,' as defined in Section 82013 (c), when their contributions aggregate $5,000 or more in a calendar year. *We will reach a contrary conclusion only when it is clear from the surrounding circumstances that the corporation and its subsidiaries acted completely independently of each other*." *Kahn, supra.* (Emphasis added.)

In applying the standard to the stated facts: the parent and its wholly owned subsidiaries "acted completely independently of each other when making campaign contributions;" the corporations did not coordinate their efforts or even inform each other when they made contributions; corporate directors did not participate in the decisions; the officers of the subsidiaries acted without informing the officers or directors of the parent; and the parent had not involved itself in the subsidiaries' campaign activities other than to set a limit on the amount they could contribute without obtaining prior approval, the Commission concluded that "[i]n light of these facts … [the parent] and its subsidiaries are not a 'combination of persons' within the meaning of Section 82013. Thus, they are not required to aggregate their contributions to determine whether one or more of the corporations is a 'committee.'" Furthermore, since the subsidiaries also acted completely independently of each other, they were not required to aggregate their campaign contributions to determine whether any of the subsidiaries were a committee under section 82013, subdivision (c).

Finally, in response to whether the parent and the subsidiaries could each make contributions of up to $4,999.99 without becoming a "committee," the Commission cautioned that "the parent corporation and its subsidiaries may not rely on their separate corporate identities to evade the reporting obligations imposed by the Political Reform Act; and the fact that each corporation made contributions of $4,999.99 might suggest that they were operating pursuant to a common plan to make contributions and to circumvent the Act's reporting requirements."

Again, the Commission emphasized at the conclusion of its opinion, that its answer was "limited to the particularized facts" of the request, adding:

> *"In most instances, a parent corporation and its wholly owned subsidiaries undoubtedly will make campaign contributions pursuant to the type of agreement or mutual understanding contemplated by our opinion in Lumsdon and, therefore, will be a combination of persons.*

> *It is only on the basis of the unique facts present in this case, which demonstrate [the parent] and its subsidiaries act completely independently of each other, that we reach a contrary conclusion." Kahn, supra.* (Emphasis added.)

IV. HISTORY – REGULATIONS AND ADVICE LETTERS

A. Regulations.

In May 1979 the Commission adopted regulation 18428 implementing the reporting rules enunciated in *Lumsdon* and *Kahn*. A comment included at the end of the regulation stated: "This regulation will apply most typically to a corporation and one or more of its wholly owned subsidiaries since there is very often coordination, direction, or approval by the parent corporation in the subsidiaries' decisions to make contributions or expenditures." The regulation, applicable to major donor and independent expenditures committees only, applied if the committee was made up of a parent and one or more "affiliated entities" as defined therein. An "affiliated entity" was defined as "a person or group of persons whose campaign contributions or expenditures are *directed or controlled* by another." (Emphasis added.) The regulation also provided that, "[a] 'parent' is the person who exercises direction or control over the affiliated entity in the making of campaign contributions or expenditures."

This regulation (which is one of the several addressed in this project), established the "direction and control" standard based on the language in *Lumsdon* and *Kahn*. Although neither *Lumsdon* nor *Kahn* expressly used the words "direction and control," the words captured the substance of the core principle articulated in *Lumsdon* and *Kahn*, i.e., that contributions should be aggregated whenever one person exercises control over the contribution decisions of another person.[5] The regulation, which has undergone several amendments since its inception, remains as the basic reporting regulation for major donor and independent expenditure committees, addressing the manner in which their aggregated expenditures are to be reported. It remained as the only regulation regarding aggregation until the passage of Proposition 73, the first state law limiting campaign contributions.

After the passage of Proposition 73 in June 1988, the Commission adopted regulation 18531.5 in June 1989, to implement, among other things, the newly imposed contribution limit provisions. Again relying on the guidance set forth in *Lumsdon* and *Kahn*, the new regulation further defined under what circumstances contributions or independent expenditures would be aggregated with respect to contribution limits. Using the same "directs and controls" standard, the regulation established two basic rules for aggregation. The first rule provided:

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[5] *Lumsdon* juxtaposed the words in two sentences: "By definition a majority shareholder exercises almost complete control … He appoints the board of directors and the officers of the company and they are subject to his ultimate direction…" *Kahn* talked of contributions that were made without "coordination or direction."

> "If the same person or a majority of the same persons in fact directs and controls the decisions of two or more entities to make contributions or expenditures to support or oppose a candidate or candidates for elective office, those affiliated entities shall be considered one person … for purposes of the contribution limitations in [the Act]." (June 1989 version of regulation 18531.5 (a).)

The second rule codified the presumption established in *Lumsdon* and *Kahn* with respect to majority shareholders:

> "Business entities in a parent-subsidiary relationship and business entities with the same controlling (more than 50 percent) owner shall be considered one person for purposes of the contribution limitations in Government Code sections 85301, 85302, 85303 and 85305, unless the business entities act completely independently in their decisions to make contributions and expenditures to support or oppose candidates for elective office. For purposes of this section, a parent-subsidiary relationship exists when one business entity owns more that 50 percent of another business entity." (June 1989 version of regulation 18531.5 (b).)

The ink had barely dried on this new regulation when in September 1990 the federal district court declared the contribution limits of Proposition 73 unconstitutional. In February 1992, the Ninth Circuit Court of Appeal affirmed the lower court's holding, finding that most of the contribution limits contained in Proposition 73 were invalid.

Thereafter, the Commission considered amendment to the regulation in light of the fact that contribution limits were no longer in effect. The proposed amendment made minor changes to the regulation, primarily deleting language relating specifically to the invalidated statutes. However, the next month these proposed amendments were withdrawn in favor of two new draft regulations reflecting the changes.

The newly proposed amendments incorporated the provisions of regulation 18531.5 into two new regulations – 18215.1 "Contributions; When Aggregated" and 18225.4 "Independent Expenditures; When Aggregated." In March 1995 the Commission repealed regulation 18531.5 and adopted the two new regulations. The new regulations, using identical language between the two except for the terms "contributions" and "independent expenditures," provided further clarity as to the Commission's policy on aggregation under the provisions enunciated originally in *Lumsdon* and *Kahn*.

Regulation 18215.1 Contributions; When Aggregated.

> "(a) Definitions. For purposes of this section:
> (1) 'Entity' shall mean any person, other than an individual;

> (2) 'Majority owned' shall mean a direct or indirect ownership of more than fifty percent;
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> "(b) The contributions of an entity, whose contributions are in fact directed and controlled by an individual, shall be aggregated with contributions made by that individual and any other entity whose contributions are so directed and controlled.
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> "(c) If two or more entities make contributions which are in fact directed and controlled by a majority of the same persons, the contributions of those entities shall be aggregated.
>
> "(d) Contributions made by entities which are majority owned by any person shall be aggregated with the contributions of the majority owner and all other entities majority owned by that person, unless such entities act independently in their decisions to make contributions."

At the time of their adoption these regulations reflected long-standing Commission advice regarding its policy on aggregation, as originally enunciated in *Lumsdon* and *Kahn*. Regulation 18225.4 stills stands in its original form. With the exception of a period of time in the aftermath of the passage of Proposition 208, the guidelines provided in regulation 18215.1, likewise, have always reflected long-standing Commission advice.

In November 1996 the passage of Proposition 208 imposed new campaign contribution limits. In September of the following year, the Commission adopted new regulations to enforce the campaign contribution limits of Proposition 208. As a result, regulation 18215.1 was repealed, as it was deemed "too vague and too narrow in its coverage to save" under the new provisions of Proposition 208.

Once again, however, the court stepped in, and in January 1998 enjoined the enforcement of the provisions of Proposition 208. The Commission chairman issued a memo stating that the new regulation implementing the provisions of Proposition 208 (regulation 18531.1, Affiliated Entities Sharing One Contribution Limit) "should not be used." The Commission later repealed the regulation in June of the same year, but no action was taken to reinstate the provisions of regulation 18215.1.

However, approximately two years later, in November 2000, California voters passed Proposition 34, again establishing campaign contribution limits. Proposition 34 replaced the broad language of the Proposition 208 version of Government Code section 85311 regarding aggregation of contributions with the current version. The new version of section 85311 was taken, almost word for word, from the previous version of regulation 18215.1, the "Contributions; When Aggregated" regulation. However, the statute expressly states that its application is limited to the contribution limits applicable to candidates for state office.

With the revocation of regulation 18215.1 in the aftermath of Proposition 208 and the rebirth of the language contained in the regulation as a new statute under Proposition 34, but only as applied to contribution limits for state candidates, again, there is currently no regulation which adequately defines Commission policy on the aggregation of contributions.

In 2001, staff examined regulatory amendments to the aggregation provisions in the aftermath of the passage of Proposition 34. At that time, staff addressed whether or not there was any ambiguity in the use of the term "directs and controls" as used in the new version of section 85311 adopted by Proposition 34. Previous usage of the term had the words linked by the disjunctive "or" rather than the conjunctive "and." The Commission concurred with staff's analysis that there is no difference in the intent of the meaning and, therefore, the two words are regarded as synonymous in their application. (Memorandum to Commission, dated 9/24/01.) The amendments made to the regulation deleted language that had been adopted pursuant to the provisions of Proposition 208, along with a reference to a repealed Proposition 208 regulation, and reinstated the direction and control language which had been previously removed as inconsistent with Proposition 208's language.

B. Advice Letters:[6]

1. Issues arising in the advice letter context.

The early advice letters regarding aggregation attempted to apply the principles set out in *Lumsdon* and *Kahn* to sort out some of the questions left unclear by those opinions, applying a direction and control standard. (*Lowell* Advice Letter, No. A-85-262; *Walsh* Advice Letter, No. I-88-139. After the adoption of regulation 18531.5 in 1989 implementing the contribution limits of Proposition 73, clarification was provided as to when contributions must be aggregated.[7] In the *Recht* Advice Letter, No. I-89-571, staff was asked to address the following questions: (1) Are contributions of a partnership aggregated with the contributions of the controlling partners, the individual shareholders of the controlling partners, or both where the partnership is controlled by a steering committee of five partners? (2) A general partnership consists of two corporate partners. The partnership is controlled by two individuals. One is the president of one of the

[6] This review of advice letter in this history does not include an exhaustive review of every letter regarding aggregation questions. However, it does provide a general overview of the application of the aggregation rules.

[7] Regulation 18531.5(a) – "If the same person or a majority of the same persons in fact directs and controls the decisions of two or more entities to make contributions or expenditures to support or oppose a candidate or candidates, those affiliated entities shall be considered one person, one political committee, or one broad based political committee for purposes of the contribution limitations specified in Government Code sections 85302, 85303 and 85305." (1994 version of regulation 18531.5(a).)

(b) Business entities in a parent-subsidiary relationship or business entities with the same controlling (more than 50-percent) owner, shall be considered one person for purposes of the contribution limitations in Government Code sections 85302, 85303 and 85305, unless the business entities act independently in their decisions to make contributions or expenditures to support or oppose candidates for elective office. For purposes of this regulation, a parent-subsidiary relationship exists when one business entity owns more than 50 percent of another business entity." (1994 version of regulation 18531.5(b).)

corporate partners. The other is the CEO of the same corporate partner. Are the contributions of the partnership aggregated with the contributions of the individuals? (3) A shareholder owns 51 percent of the stock of a corporation and directs and controls the corporation. Are the contributions of that shareholder aggregated with the corporation?

Using a "two lines of authority" test established under *Lumsdon* and *Kahn,* and regulation 18531.5, the letter advised that since *Lumsdon* concerned *only one individual* with a wholly owned corporation, *its reasoning could not be applied to more than one individual*, and since regulation 18531.1 only apples to entities, it was not applicable here with respect to question one but would apply to question two. Accordingly, the response provided was: (1) Since no single member of the steering committee in fact directs and controls, aggregation of the contributions between the partnership and any individual is not required; (2) Aggregation of contributions would be required between the partnership and the one corporation, since they are both directed and controlled by a majority of the same individuals, but aggregation between the partnership and the individuals is not required; and (3) Contributions of the majority shareholder and the corporation are aggregated under *Lumsdon*.

Thereafter, the advice focused primarily on who actually "directs and controls" the contribution decisions of the entity in question to determine whether the rules on aggregation applied. If the decision was made by one individual, aggregation would be required between that individual's contributions and those of the entity or entities whose contribution decisions he or she controlled. If the decision was made by more than one individual, aggregation was not generally required unless there was a majority of the same individuals controlling two or more entities, in which case aggregation would be required among the entities. (See generally, *Farley* Advice Letter, No. A-89-628, *Pines* Advice Letter, No. I-89-703, *Grant* Advice Letter, No. I-90-144, *Olson* Advice Letter, A-90-302, *Boyle* Advice Letter, A-90-120, *Rossi* Advice Letter, No. I-93-211, *Bagatelos* Advice Letter, No. I-90-457, and *Sutton* Advice Letter, No. A-95-156.)

Recent advice letters subsequent to the passage of Proposition 34 implementing the current contribution limits continue to apply the same general principles enunciated in the opinions. For example, in the *Fechner* Advice Letter, No. I-03-263, the requestor was advised that a company president who owned the company in equal shares with his three sisters, but where he was the only sibling active in the management of the company, and he directed and controlled the company, was required to aggregate his contributions with those of the company, but his sisters were not. In the *Mitchell* Advice Letter A-01-210, several questions were raised as to when an Assembly candidate would be required to aggregate his personal contributions with contributions from his various business interests, one in which he had a majority ownership, another a 50 percent ownership, and in still another, a one-third ownership. The letter advised that if the candidate "actually directs and controls" the contributions of any of these entities he would be required to aggregate his personal contributions with those entities whose contributions he directed and controlled.

2. Current statutes and regulations do not provide sufficient guidance as to when a single individual must aggregate contributions; i.e., is the same "person" for purposes of the reporting and contribution limits of the Act.

The advice letters have clearly limited the application of the aggregation principles developed in *Lumsdon* and *Kahn* and under the direction and control test to a single individual, when determining who makes the decisions for an entity not majority owned by another entity. However, there has been little discussion of how direction and control is determined or what factors may support a conclusion that persons acted independently of each other in order to establish that the same person, or a majority of the same persons, did not direct and control each of the separate payments.

The primary reason for this, of course, is that both opinions and advice letters are based on the facts presented. If the facts state that a person does or does not have direction and control, those facts are accepted, and the aggregation determination is based thereon. The primary factor in making this determination is thereby based on a decision that has already been made and accepted.

As further discussed below, part of what this regulatory project examines is whether or not the single individual test, as stated in the advice letters, should be the limit of the "directs and controls" standard in determining aggregation of an entity's contributions. Proposed regulation 18205, in particular, is instructive as to whether an entity's contributions should be aggregated with any individual only when there is a single individual making the decision, or should aggregation be applied equally in situations when two, or more than two, individuals make the decision.

V. DISCUSSION OF AFFECTED STATUTES AND REGULATIONS

As stated above, the rules for aggregation of contributions and independent expenditures developed the *Lumsdon* and *Kahn* opinions, and later evolved into the "direction and control" standard, where contributions and independent expenditures are aggregated when the same person or a majority of the same persons directs and controls the expenditures of more than one person. While the test appears fairly straightforward, there are substantial questions relating to what factors are to be examined in determining whether or not direction and control exists. While the issue may not have been of paramount concern in relation to the major donor reporting threshold, in a world with contribution limits, staff suggests that the current test for aggregation may require closer scrutiny to ensure that those limits are enforceable and to further the purposes of the Act.

To review, the current statute, regulation, and proposed regulation, as applied under long-standing advice, require contributions or independent expenditures to be aggregated when:

1. Contributions of an entity that are directed and controlled by any (single) individual shall be aggregated with the contributions of that individual and any other entity whose contributions are directed and controlled by the same individual;

2. If two or more entities make contributions that are directed and controlled by a majority of the same persons, the contributions of those entities shall be aggregated.

In addition, the Act requires that contributions made by any entity that is majority-owned by any person be aggregated with the contributions of the majority owner and all other entities majority owned by the person, *unless those entities act independently in their decisions to make contributions*. [8]

Staff seeks the Commission's determination on various issues as discussed below.

Proposed Adoption of Regulation 18205: Proposed new regulation 18205 is the heart of the aggregation requirements examined in this regulatory project and is intended to provide guidance as to how direction and control is established, whether the direction and control test can be applied to only one individual or more than one, and what factors are needed to establish when the circumstances are clear that an individual and an entity or multiple entities acted independently of each other in their decisions to make contributions.

Subdivision (a) of proposed regulation 18205 provides that the Act's aggregation provisions apply to the requirements of Chapter 4[9] and Chapter 5 of the Act.

In addition, the proposed language provides guidance on what circumstances a presumption of "direction and control" exists as enumerated in *Lumsdon* and *Kahn* for the purpose of aggregating contributions or independent expenditures. Subdivision (a) further provides that a person directs and controls the making of the payment under four situations.

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[8] It should be noted that at the inception of this project, it was referred to as the "Affiliated Entities Regulation Project," because the whole principal of aggregation was based on the concept of "affiliated entities." Some of the suggestions received as a result of the Interested Person Meeting involved defining "affiliated entities" as part of the project.

The term was first used in regulatory form with the original adoption of regulation 18428 in 1979 and defined as a "person or group of persons whose campaign contributions or expenditures are directed or controlled by another." The definition was dropped from this regulation, and a new definition provided in a separate regulation adopted under the regulatory changes pursuant to Proposition 208. That regulation was rescinded after the court ruled Proposition 208 provisions invalid. (See Exhibit 1, September 1997 and January 1998 comments and footnotes thereto.) This left the term, although still in use, including its current use in the title of section 85311, without a definition.

In examining the issue of what definition to apply, staff determined that any definition of "affiliated entities" merely encompassed an explanation of when contributions would be required to be aggregated. The use of this terminology added an unnecessary layer to the whole process, perhaps creating some confusion. To resolve that issue, staff has deleted the term "affiliated entities" in favor of focusing on when contributions are aggregated.

[9] Concurrent with this project, the Commission is considering adoption of a new regulation applicable to contributions limits to parties to a proceeding under section 84308. While the aggregation provisions proposed herein would be applicable to that section, as it is contained in Chapter 4, the those provisions would be superseded with respect to that section with respect to business entities who fall under the definition of parties as provided, if the Commission adopts proposed regulation 18538.5.

Subdivision (a)(1), restates the majority owner presumption and clarifies that the majority owner is presumed to have direction and control unless it can be established otherwise.

Subdivision (a)(2) provides an option under **Decision Point 1** limiting direction and control to either a single individual or expanding potential direction and control to any individual or entity that is involved in the decision-making process. This subdivision is discussed as a separate issue below.

Subdivision (a)(3) addresses both the 50/50 owner situation and other instances where an individual has final authorization over the making of the payment, although the individual did not participate in the decision, other than to grant his or her consent. This would apply to a 50/50 partnership, where although one partner makes the decision, the other, by virtue of his or her equal share in the partnership, must consent. The language provided would also bring in a president or CEO of an entity who must give final approval to any decisions, even though he or she did not take part in the making of the decision, essentially including anyone with a veto power over the decision.

Finally, subdivision (a)(4) establishes the presumption that a sponsored committee is directed and controlled by its sponsor. (See *Breckenridge* Advice Letter, No. I-94-126.)

Decision Point 1: Should aggregation be required only if a single individual (or a majority of the same individuals) directs and controls the contributions of an entity?

Subdivision (a)(2) raises an issue that frequently arises with respect to the application of aggregation rules to a single individual. The "single individual test" was first applied in the *Recht* Advice Letter, *supr*a, and had been used ever since. The reasoning for this rule was based on the fact that since *Lumsdon* concerned only an individual with a wholly owned corporation, its reasoning could not be applied to more than one individual. Therefore, any time a decision was made by, say, two partners, or any group that consisted of more than one decisionmaker, the contributions of the entity would not be aggregated with any one individual. But is this what the Commission intended by its conclusion in *Lumsdon*?

Arguably, the language in *Lumsdon* might suggest otherwise. *Lumsdon* was based on the theory that a committee was a "combination of persons." This was defined as a group of persons acting in concert or an alliance of two or more persons working as a team. Although *Lumsdon* applied this "combination of persons" to the individual owner and his wholly owned entity, was it the Commission's intent that this combination would no longer exist if two people had together made the decision to make the entity's contribution, or that if analyzed under a "direction and control" standard rather than a "combination of persons" standard its application would be limited to only one individual?

Since the analysis in *Lumsdon* was based in terms of what may constitute a "combination of persons" for purposes of defining a major donor committee, involving

only the single individual and his closely held corporation, much of the analysis may not apply when determining when contributions need to be aggregated for purposes of contribution limits under the direction and control test. But the question remains as to whether it was a proper reading of *Lumsdon* to limit direction and control to cases involving only one individual and, if not, does a reading of the statutory language "contributions are directed and controlled by any individual" nevertheless, limit the meaning to only one individual or could it include multiple individuals?

This question most often arises with respect to 50/50 partnerships. In theory, one individual could be involved in numerous such partnerships, each with a different partner. As long as the partners each made the decisions for the various partnerships, and no one individual directed and controlled the expenditures, each of the partnerships could make contributions that would not be aggregated with any of the individuals or with each other. One individual could thereby have an impact on multiple contributions, if by no other means than his or her veto power over the partnership decisions, without the contributions counting toward his or her contribution limit.

Proposed Language of Subdivision (a)(2): As stated, the current advice is that aggregation is only required if one individual directs and controls, but if more than one individual directs and controls the payment, aggregation with any of the individual's personal contributions is not required. Language is provided under **Decision Point 1**, in subdivision (a)(2) that would bring in more than one individual who participates in the decisionmaking process. This language, if adopted, would include anyone that took part in the decision to make the payment. For example, if the decision was made by a committee of three people, each deciding to make the payment, all three would be required to aggregate their personal contributions with that made by the entity. What the proposed regulation does not address is what percentage of the entity's contribution would be aggregated with each of the individuals who made the decision. If the Commission were to expand the direction and control test beyond its current application to a single individual, further language would need to be added to determine how the total payment is aggregated with each of the individuals making the decision.

Subdivision (b) proposes a standard for determining when it is clear from the surrounding circumstances that an entity acted independently from its majority owner by offering factors to determine the circumstances establishing such independence of action between entities. Subdivision (b)(1) applies to entities that are majority owned by another entity and (b)(2) to entities that are majority owned by an individual. The factors are the same for both, except that an individual would additionally need to show that he or she exercised no control over the day-to-day decisions of the entity. The majority owner would have to establish that all of the listed factors were applicable.

Proposed language of subdivision (b): The three factors that apply to both entities that are majority owned by an individual or by another entity are:

(1) The entity making the payment must have a written procedure, approved by the majority owner, that allows the entity to make the payment without consulting the majority owner;

(2) The entity making the payment did not consult with the majority owner in the decision to make the payment; and,

(3) The majority owner did not participate in the entity's decision-making process, including the selection of the individuals who make the decision.

A fourth criterion is added if the entity is majority owned by an individual, and was developed based on the language in *Lumsdon*, where the Commission stated:

> By definition, a majority shareholder exercises almost complete control over the activities of a closely held corporation. He, for all practical purposes, appoints the board of directors and the officers of the company and they are subject to his ultimate direction in arriving at decisions. If they are not responsive to his desires, he can easily replace them. Accordingly, corporate action generally reflects the judgment and beliefs of the majority shareholder. Moreover, to ignore the nature of the relationship between a majority shareholder and his closely held corporation and treat them as separate entities would have the effect of raising the major donor reporting threshold…." (*Lumsdon, supra.)*

Accordingly, criterion (4) would require the majority shareholder to establish that he or she does not exercise the day-to-day control of the entity. This could be established, for example, by showing that the majority shareholder has retired and turned the entity's control over to another, or that the majority owner has a partner who runs the entity without routine input from the majority owner, or similar circumstances where the majority owner is not involved in the operation of the entity.

As shown above, the major policy issue under subdivision (b) is what circumstances are needed to establish that entities act independently of the majority owner in the decisions to make contributions, in order to rebut the presumption that the contributions of the entity are directed and controlled by the majority owner?

This presumption is based on the direction provided in *Lumsdon* and *Kahn*. In *Lumsdon* the Commission established the presumption for an individual and his closely held corporation, based on the facts that the individual exercised almost complete control over the activities of the corporation, including appointing the directors and officers who were subject to his ultimate direction in arriving at decisions, and who may easily be replaced if they were not responsive to his desires. It included language that the presumption of control was inapplicable only if it was clear from the surrounding circumstances that the individual and the entity acted completely independently of each other. It, however, did not provide any guidance as to what those circumstances might be.

Kahn applied the same presumption to a parent corporation and its wholly owned subsidiary. However, *Kahn* did find circumstances, based on the acceptance of the facts submitted, that an independence of action was established. It cautioned, however, that the finding was limited to the particularized facts presented, and that in most instances a parent corporation would be determined to direct and control its wholly owned subsidiary.

This presumption has been codified in the statute and regulations addressing aggregation and applied consistently in advice letters. But the exception to the presumption, "unless those entities act independently in their decisions to make contributions," appears now to be determined by the direction and control test, effectively removing any presumption and instituting the same standard for majority-owned entities as is applicable to any other entity.

Staff seeks the Commission's determination as to whether the language proposed under regulation 18205 (b) provides an appropriate standard to determine what constitutes evidence supporting a finding of independence of action to rebut the presumption of aggregation. This determination is especially significant with respect to an individual and his or her majority owned corporation, given the language in *Lumsdon* that indicates evidence of the individual's complete authority over the entity's actions.

Proposed Adoption of Regulation 18215.1 and Amendment to Regulation 18225.4: As stated above, Government Code section 85311 in its present form, incorporated into the Act under Proposition 34, is essentially the same language as was used in former regulation 18215.1, the Commission's "Contributions; When Aggregated" regulation, until it was repealed in the wake of Proposition 208 as "too vague and too narrow in its coverage to save" under those provisions. Because the current statute applies only to the contribution limits for state candidates imposed by Proposition 34, the Commission is once again without a regulation defining when contributions are to be aggregated in situations other than those applicable under section 85311 (i.e. major donor committees, section 84308 limits, advertisement disclosure and other purposes under Chapters 4 and 5, and for local campaign limits where the Commission's aggregation provisions are applied).

Proposed new regulation 18215.1 fills that gap and adopts the identical language used in the statute in order to maintain consistency in the application of the aggregation provisions. Along the same lines, the **proposed changes to regulation 18225.4**, the original sister regulation to regulation 18215.1 applying to independent expenditures, modify that regulation to conform to the provisions of the statute and the language of the proposed new regulation 18215.1, and establish consistency throughout the provisions requiring aggregation.

Proposed Amendment to Regulation 18428: Finally, Regulation 18428 is the basic reporting regulation for major donor and independent expenditure committees that was adopted in 1979 pursuant to the *Lumsdon* and *Kahn* opinions. The regulation has undergone numerous amendments since its inception. One of the issues raised at the

interested person meeting was that the regulation was too confusing and difficult to understand. The proposed amendments hope to clarify some of that confusion.

Subdivision (a) deletes the reference to "affiliated entities" and clarifies that the rules regarding the reporting of aggregated contributions and independent expenditures are applicable to the monetary threshold established in Chapter 4 and Chapter 5 of the Act, and that the regulation is not just applicable to major donor or independent expenditure committee reports.

Subdivision (b) identifies the filing procedures for major donor and independent expenditure committees. The requirement that the report shall be filed in the name of the individual who directs and controls the making of an entity's payment and reflect the total payments aggregated, remains the same as current subdivision (b), although the language has been modified somewhat. However, **Decision Point 2** now provides two options for the identification required under the name of filer. The first option requires the filer to include the name of all entities, whose contributions are included in the report, to be included in the "name of filer" section of the report. This option was included at the suggestion of the Enforcement Division. The second option provides that the report only indicate under the name of filer that the report includes aggregated contributions from other entities (e.g. "Name of Filer" including aggregated contributions). This option is how the regulation is currently interpreted and is the method preferred by the Technical Assistance Division.

Subdivision (c) sets out the reporting provisions for recipient committees who receive aggregated contributions. Under current subdivision (d), the recipient committee is required to "report the contribution as received from the contributor 'and its affiliated entities,' but shall not be required to list the name of each affiliate." Under the proposed amendments, the recipient committee would now be required to report both the name of the "filer" and the name of each entity directed and controlled by the filer from whom it received contributions. This addresses the situation raised by Mr. Nielsen at the interested persons' meeting.

The final proposed amendment under this regulation is contained in **Decision Point 3.** This would apply the aggregation rules to reporting by recipient committees, directed and controlled by the same individual or a majority of the same individuals, so that the recipient committee would have to disclose on its report any contributions it made that are aggregated with another individual or entity and additionally, notify the recipient of that contribution that the contribution is required to be aggregated with any contribution made by the individual or entity who directs and controls the recipient committee making the contribution.

The currently proposed regulation does not contain any provisions for persons, other than committees, to report aggregated contributions. Given the newly established contribution limits, staff suggests that that Commission may wish to consider reporting requirements for persons who are required to aggregate contributions, but do not meet the reporting thresholds as a committee. For example, should an individual who makes a $100 contribution to a State Senate candidate from his or her personal account and

another $100 contribution from his or her directed and controlled business account, be required to notify the recipient that the contributions are aggregated for the purposes of the contribution limits? Staff has found no specific authority for this requirement, other than to further the purposes of the Act by implementing the campaign contribution limits. If the Commission desires to address this issue, staff suggests that the issue be examined in a separate regulatory project in the future.

Proposed Adoption of Regulation 18531.11: Lastly, proposed regulation 18531.11 is proposed as a reference to the provisions of proposed regulation 18205 in applying the aggregation rules in Government Code section 85311.

Staff Recommendation: Staff seeks guidance from the Commission on the various policy issues raised by the proposed regulations or proposed amendments. Based on the Commission's determinations staff would proceed with either adoption or further prenotice discussion.

Legal: aggregation prenotice memo 1-10-06.doc

Attachments

Proposed regulation 18215.1
Proposed amendments to regulation 18225.4
Proposed regulation 18205
Proposed amendments to regulation 18428
Proposed regulation 18531.11